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IN THE

Supreme Court of the United States

OCTOBER TERM, 1957.

No. 119

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

NEIL SULLIVAN AND GRACE SULLIVAN.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

JAMES ROSS AND ANN ROSS.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

SAM MESI.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR RESPONDENTS.

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BRIEF FOR RESPONDENTS.

Petitioner's Brief adequately presents the Opinions Below, Jurisdiction, Statutes Involved and Statement.

QUESTION PRESENTED.

Respondents conducted bookmaking businesses in Illinois, a state in which such activity is unlawful. In the operation of such businesses they made payments for the rental of the premises within which such businesses were conducted and for the wages of their employees.

The question is whether the expenses of rent and wages incurred in the operation of the trade or business, and specifically allowable as deductions from gross income in computing net income under the provisions of Section 23(a)(1)(A) of the Internal Revenue Code of 1939, are nonetheless not deductible because of Illinois statutes relating to criminal law.

SUMMARY OF ARGUMENT.

Section 23(a) of the Internal Revenue Code of 1939 by its plain, unambiguous provisions, permits the deduction from gross income of all ordinary and necessary expenses incurred in a trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered and for rent. The expenses claimed here by respondents are for wages incurred in the operation of their illegal bookmaking businesses, and for rent incurred in the operation of one of these businesses. There is no issue raised as to either the amount of the claimed deductions nor whether they were incurred in a trade or business. Since an unlawful trade or business is within the purview of Section 23(a), there is no basis upon which the claimed deduction can be disallowed.

The "public policy" argument upon which petitioner relies to deny the deductions is inapplicable since there is no ambiguity in the statute justifying the application of any other policy than that established by its provisions.

Cases relied upon by petitioner proceed from the assumption that application of another policy does no violence to the provisions of the statute. Many of these cases, in fact, distinguish expenses denied on the grounds of public policy from the very kind of expenses here claimed by respondents, expenses which have always been held to be deductible, even when incurred in an unlawful business.

The Tax Court and the Commissioner, until the present cases, have consistently allowed the deduction of expenses by an unlawful business without regard to the legality of the business or the expense, so long as the expenses were otherwise ordinary and necessary.

The legislative history of Section 23(a) and other sections relating to the taxability of unlawful gambling enterprises supports the clearly expressed statutory language that no distinction is drawn for purposes of taxation between lawful and unlawful businesses or lawful and unlawful expenses.

If Section 23(a) were to be construed to exclude from its provisions, because of the operation of state criminal law, expenses otherwise clearly ordinary and necessary, the statute would be of doubtful constitutionality.

Petitioner's theory of "independently illegal" expenses is not supported by the statute, by Congressional intent, by prior decisions or by Illinois law.

Petitioner's position is motivated by the fact that respondents' businesses were unlawful, and in seeking to tax them on a basis different from other taxpayers he usurps the legislative function and assumes a power which he does not have.

ARGUMENT.

1. "Public Policy" May Be Used to Resolve the Uncertainty of an Ambiguous Statute, But Has No Application Where the Meaning of the Statute Is Clear.

This Court has considered the relationship between public policy and Section 23(a) in *Textile Mills Securities Corp.* v. *Commissioner*, 314 U. S. 326 (1941), *Commissioner* v. *Heininger*, 320 U. S. 467 (1943) and *Lilly* v. *Commissioner*, 343 U. S. 90 (1952).

In only one of these, *Textile*, was the claimed deduction disallowed. There the Commissioner had disallowed as deductions under Section 23(a) payments for lobbying and propaganda to procure passage of legislation permitting the recovery of properties seized during World War I under the Trading with the Enemy Act. The Tax Court had reversed the Commissioner, and the Court of Appeals for the Third Circuit had reversed the Tax Court. In affirming the disallowance of the deduction, this Court clearly pointed out that the general policy against lobbying came into play only because the statute did not clearly authorize such deductions, and indicated that had Congress provided otherwise, the general policy would not have applied. On this subject the Court stated:

> "Contracts to spread such insidious influences through legislative halls have long been condemned * * * Whether the precise arrangement here in question would violate the rule of those cases is not material. The point is that the general policy indicated by those cases need not be disregarded by the rule-making authority in its segregation of non-deductible expenses. There is no reason why, *in absence of clear Congressional action to the contrary*, the rule-making authority

> cannot employ that general policy in drawing a line between legitimate business expenses and those arising from that family of contracts to which the law has given no sanction. The exclusion of the latter from 'ordinary and necessary' expenses certainly *does no violence* to the statutory language. The general policy being clear it is not for us to say that the line was too strictly drawn." 314 U. S. 326, 338-339. (Emphasis added.)

In *Heininger* the Commissioner attempted to disallow the deduction of expenses incurred in the unsuccessful defense of a Post Office fraud charge. This Court affirmed the reversal by the Court of Appeals of the Commissioner and Board of Tax Appeals, stating that Section 23(a) contained no express reference to the lawful or unlawful character of the business expenses which are declared to be deductible. In defining the issues, the Court stated:

> "There can be no doubt that the legal expenses of respondent were directly connected with 'carrying on' his business * * * Our inquiry therefore is limited to the narrow issue of whether these expenses were 'ordinary or necessary' within the meaning of Section 23(a)." 320 U. S. 467, 470.

Thus, as in *Textile*, the Court again recognized that legislative intent is paramount.

The *Lilly* decision forcefully stated that "public policy" as such had nothing to do with deductibility of ordinary and necessary expenses under Section 23(a), but rather the question was whether the expenses were "ordinary and necessary" within the meaning of Section 23(a). There the Commissioner attempted to disallow, solely on the basis of public policy, a deduction for "kickbacks" to opticians by eye-glass manufacturers, of one-third of the sales price of eye-glasses sold to the opticians' patients. The Court, in rejecting this "public policy" argument, stated:

> "There is no statement in the Act, or in its accom-

panying regulations, prohibiting the deduction of ordinary and necessary business expenses on the ground that they violate or frustrate 'public policy'.

The Tax Court in the instant case made no finding of fact that the payments to the doctors were not ordinary and necessary business expenses. It sustained the Commissioner's disallowance of their deductibility because it held that, as a matter of law, the contracts under which the payments were made, violated public policy.

We do not have before us the issue that would be presented by expenditures which themselves violated a federal or state law or were incidental to such violations. In such a case it could be argued that the outlawed expenditures, by virtue of their illegality, were not 'ordinary and necessary' business expenses within the meaning of § 23(a)(1)(A)." 343 U. S. 90, 94-95.

The suggestion in *Lilly* that "it could be argued" that expenditures which themselves violated a federal or state law were not "ordinary and necessary" business expenses appears to have been accepted by petitioner as a direction that such expenses are not deductible as a matter of law.

This, of course, is not what was said in *Lilly*, *Heininger*, or *Textile*. In each of these cases it was recognized that Congressional intent is the primary consideration, and only where this intent is not clearly stated—as in *Textile*—could other policy considerations enter into the determination of the deductibility of expenses under Section 23(a). *Textile* clearly held that even though lobbying activities were contrary to "general policy" such expenses were not deductible because of "the absence of clear Congressional action to the contrary." Only because the following of the general policy against such expenditures "does no violence to the statutory language" was the expense disallowed as a deduction. 314 U. S. 326, 338-339.

These principles as applied by this Court in its consideration of Section 23(a) are but a specific application of gen-

eral principles applicable to the whole federal tax scheme and to statutory construction generally.

It has been consistently held that the revenue laws are to be construed in the light of their general purpose to establish a nationwide scheme of taxation uniform in its application.

> "Hence their provisions are not to be taken as subject to state control or limitation unless the language or necessary implication of the section involved makes its application dependent on state law." *United States* v. *Pelzer*, 312 U. S. 399, 402-3 (1941).

In *Burnet* v. *Harmel*, 287 U. S. 103, 110 (1932), the Court stated:

> "Here we are concerned only with the meaning and application of a statute enacted by Congress, in the exercise of its plenary power under the Constitution, to tax income. *The exertion of that power is not subject to state control. It is the will of Congress which controls*, and the expression of its will in legislation, in the absence of language evidencing a different purpose, is to be interpreted so as to give a uniform application to a nationwide system of taxation * * * State law may control only when the federal taxing act, by express language or necessary implication, makes its own operation dependent upon state law * * *." (Emphasis added.)

To the same effect, see *United States* v. *Gilbert Associates, Inc.*, 345 U. S. 361, 364 (1953); *Lyeth* v. *Hoey*, 305 U. S. 188, 194 (1938); *Heiner* v. *Mellon*, 304 U. S. 271, 279 (1938); *Thomas* v. *Perkins*, 301 U. S. 655, 659 (1937).

Petitioner argues that the public policy of Illinois is declared in its statutes (Pet. Br. 30). It is also found in its decisions and primarily in its Constitution. But it was held in *Gunn* v. *Dallman*, 171 F. 2d 36, 37 (C. A. 7, 1948), cert. den. 336 U. S. 937 (1949), that "the federal government's

power to tax cannot be limited by the provisions of a state constitution."

Petitioner has nowhere demonstrated any ambiguity, confusion, or uncertainty in the terms of Section 23(a) which would warrant the disallowance of the expenses for rent and salary. The wage payments made in violation of the Defense Production and Wage Stabilization Acts—upon which he strongly relies (Pet. Br. 22-23)—are clearly inappropriate to this analysis, since such expenses are denied on the strength of specific statutory authorization that provision may be made to disallow the expenses for tax purposes. Defense Production Act of 1950, Sec. 405(a), 50 U. S. C. App. Sec. 2105(a); Stabilization Act of 1942, Sec. 5(a), 50 U. S. C. App. Sec. 965(a); *Cf. Woodworth Co.* v. *Kavanaugh*, 102 F. Supp. 9 (Mich., 1952) (Pet. Br. 22), and *Pédone* v. *United States*, 151 F. Supp. 288 (Ct. Claims, 1957) (Pet. Br. 22).

His citation of numerous decisions relating to expenditures such as bribes, fines and penalties, and defense of criminal prosecutions cannot cast any light on the meaning of the statute insofar as the particular expenses here involved are concerned. In fact, as will subsequently be shown, many of the cases cited by him deny the very meaning he asserts for them when applied to expenses of rent and wages.

The sole decision cited by petitioner having any connection with the deductibility of expenses of rent and wages by one unlawfully engaged in the business of bookmaking (*Silberman* v. *Commissioner*, 44 B. T. A. 600 (1941), Pet. Br. 15) has been grossly miscited by petitioner as will be demonstrated below (*infra*, pp. 13-15).

Petitioner must demonstrate where Section 23(a) permits application of any policy other than that clearly expressed by its terms. He does not meet this obligation by reference

to Illinois law or by voluminous citation of decisions having nothing to do with expenses of rent or wages.

> "We may grant, if a policy exists, that it may be used to resolve the uncertainty of a law, but it cannot be a substitute for a law." *Fullinwider* v. *So. Pac. R. R.*, 248 U. S. 409, 412 (1919).

2. Section 23(a)(1)(A) of the Internal Revenue Code of 1939, by Its Clear and Unambiguous Terms, Requires the Allowance of the Deductions Claimed.

The Court below based its decisions in the present cases upon its prior decision in *Commissioner* v. *Doyle*, 231 F. 2d 635 (C. A. 7, 1956), a case which presented the precise issues involved here. Doyle was a bookmaker operating in Illinois and petitioner sought to disallow the deductibility of Doyle's expenses for rent and wages. The Tax Court there decided against the petitioner and the Court of Appeals affirmed. The decision is set out as an appendix to petitioner's brief here (Pet. Br. 39).

The decision in *Doyle* was simply that "The language of Section 23 is clear and unambiguous. Its application to this case requires an affirmance of the Tax Court's decision." Citing *Textile*, the Court observed that "Here is 'clear Congressional action' contrary to the Commissioner's position." 231 F. 2d 635, 636.

There can be no question about the soundness of this holding.

Section 23(a)(1)(A) provides in part as follows:

> "In computing net income there shall be allowed as deductions:
>
> (a) Expenses.
>
> (1) Trade or business expenses.
>
> (A) In general. All the ordinary and necessary expenses paid or incurred during the tax-

> able year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * * and rentals. * * *."

The literal language of this section certainly permits the deduction of the classes of expenses—wages and rent—claimed by respondents. No issue has ever been raised in these proceedings as to the amount of the deductions claimed by respondents or whether the expenses were incurred in their trade or businesses. There is no limitation of any kind with respect to the legality of the trade or business in which the expenses are incurred, nor can there be any doubt that such expenses are "ordinary and necessary" since they are specifically defined as such in the section. "The language of 23(a) contains no express reference to the lawful or unlawful character of the business expenses which are declared to be deductible." *Commissioner* v. *Heininger*, 320 U. S. 467, 474 (1943).

Because of the specific definition of the kinds of expenses here involved as being "ordinary and necessary" petitioner could scarcely contend that "ordinary and necessary" does not include them. These are not expenses such as payment on judgments for Price Control Act violations (*Lentin* v. *Commissioner*, 226 F. 2d 695 (C. A. 7, 1955)), or lobbying and propaganda expenses (*Textile Mills Securities Corp.* v. *Commissioner*, 314 U. S. 326 (1941)), or illegal rebates (*Boyle, Flagg & Seaman, Inc.*, 25 T. C. No. 8 (1955)), none of which are specifically defined as "ordinary and necessary," and hence allow for application of a general policy against their deductibility.

Neither could petitioner claim that the activities of respondents in pursuit of which these expenses were incurred are not a "business" for petitioner himself, as well as Congress (as shall be shown) recognizes that gambling—whether legal or illegal—is a business within the meaning of

Section 23(a). Thus in Revenue Ruling 54-219, Cumulative Bulletin 1954-1, p. 51, petitioner has held that the federal excise tax on wagers and the special tax paid by persons engaged in receiving wagers are deductible as ordinary and necessary business expenses under Section 23(a). This Ruling is set out as Appendix A to this brief. And in his brief in the instant case, petitioner, to avoid the admonition in *Commissioner v. Heininger*, 320 U. S. 467, 474 (1943), states he is not "contending that Congress intended to tax the gross income of one business and the net income of another." (Pet. Br. 13.) To prove his sincerity in this respect, petitioner states that "when a bookmaker buys paper or pencils, or gasoline for his car, it is not necessarily an illegal transaction." (Pet. Br. 27.) It is not readily apparent why, under petitioner's theory of public policy, even these expenditures should be permitted as deductions (see *infra*, pp. 31-32).

If further support for the plain meaning of the statute is required it is found in the legislative history of Section 23(a) and other provisions of the Code, in the various attempts of petitioner to avoid this plain meaning in prior litigation and in recent action of Congress in the taxation of the business of gambling.

3. Prior Tax Court Decisions Affirm the Plain Meaning of the Statute.

The subject of taxation and illegal gambling appears to have been first discussed by the Board of Tax Appeals in *Appeal of McKenna*, 1 B. T. A. 326 (1925). McKenna was a bookmaker operating illegally. Both he and the Commissioner raised the ultimate issue in this area. McKenna claimed he was not taxable at all and the Commissioner claimed he was taxable on his gross receipts and could not deduct amounts paid out on winning wagers, amounts re-

turned to bettors because the horse upon whom the bet had been placed did not run, and amounts bet by McKenna with other bookmakers—so-called layoff bets. Each supported his position with the same argument—the business was illegal. McKenna argued that this made his income immune from taxation and the Commissioner argued that this made his expenses unavailable to reduce that income. The Board of Tax Appeals rejected both contentions. "* * * Gambling is not an offense *malum in se* but is merely *malum prohibitum* in certain State jurisdictions. It is not even *malum prohibitum* under Federal law." 1 B. T. A. 326, 330. Thus the Board recognized what the Supreme Court has so often said—the revenue laws have as their general purpose the establishment of a uniform scheme for taxation, not subject to state control or limitation.

Nine years later, in 1934, there first appeared in the Code present Section 165(d), that "Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions." This was Section 23(h) in the 1939 Code, and Section 23(g) when it first appeared in the Revenue Act of 1934.

The House Committee Report on the 1934 Revenue Act stated with reference to the new section:

> "Existing law does not limit the deduction of losses from gambling transactions where such transactions are legal. Under the interpretation of the courts, illegal gambling losses can only be taken to the extent of the gains on such transactions. *A similar limitation on losses from legalized gambling is provided for in the bill.* Under the present law many taxpayers take deductions for gambling losses but fail to report gambling gains. This limitation will force taxpayers to report their gambling gains if they desire to deduct their gambling losses." (Emphasis added.) House Report 704, 73 Cong., 2d Sess. (1934). (Cum. Bull. 1939-1, Part 2, p. 554, 570).

It is thus apparent from the *McKenna* case and the legislative history of Section 165(d) that disbursements in connection with illegal gambling—clearly violative of many state laws—were recognized as valid deductions prior to the passage of that section, the purpose of that section being to impose the same limits on legal gambling transactions that already existed on illegal gambling transactions.

In commenting on this section, the Court of Appeals for the Fifth Circuit stated that all gambling losses could be deducted to the extent of gambling gains without regard to the legality of the transactions. "No longer need it be inquired whether the wagers were illegal so that the loss need not have been paid; nor what the state of mind of the taxpayer was as respects his purpose to win a profit." *Humphrey* v. *Commissioner*, 162 F. 2d 853, 855 (C. A. 5, 1947), cert. den. 332 U. S. 817 (1947).

This development certainly does not manifest any attitude on the part of Congress that illegal gambling was to be treated, for federal tax purposes, differently than any other business. Once *McKenna* passed the ultimate point—whether pay-outs on illegal wagers were deductible—and Congress acknowledged and codified this position in 1934, then it was inevitable that Section 23(a) should treat gambling—whether legal or illegal—as any other business.

Litigation in the Tax Court after *McKenna* confirmed the plain meaning of Section 23(a)—that ordinary and necessary expenses of an illegal gambling business were deductible, and that wages and rent were such expenses.

The first significant decision was *Israel Silberman*, 44 B. T. A. 600 (1941), cited by petitioner at page 15 of his brief. There the taxpayer operated as a "betting commissioner" at various New York race tracks, paying certain fees for the use of space and wages to clerks registering bets. New York had in effect a statute similar to that of

Section 336 of the Illinois Criminal Code, prohibiting the occupancy of premises for that purpose and prohibiting the registering of bets. The taxpayer realized no profit from his illegal operations and sought to deduct these expenditures from income from lawful sources. The decision did state that "expenditures made in the carrying on of activities which in themselves are in contravention of law and illegal have been held to be not deductible as business expenses on grounds of public policy." *Ibid.*, at 603-4. The expenses for rent and salaries in *Silberman* fell within this prohibition, said the Board, because, first, the New York Statute makes it illegal to let a booth to receive bets and to assist in the receiving and recording of bets, and—

> "Second, the petitioner in claiming deduction for these expenditures seeks to offset such expenditures against income from lawful sources received from other legal business activities, and to thereby obtain reduction of tax upon that income. *Such claim differs from a claim that the income to be taxed from an illegal business is the net income received therefrom. Cf. James P. McKenna*, 1 B. T. A. 326. In reality petitioner sustained loss from his illegal business activities and seeks deduction for part of the loss in the guise of a claim for a deduction for business expenses. Under the rule in *Mitchell M. Frey, Jr., et al., Executors, supra*, losses sustained in illegal gambling operations are not deductible." 44 B. T. A. 604. (Emphasis added.)

Further, the Board made the following finding of fact:

> "Petitioner did not realize any income or gains or profits in the taxable year from his activities in making, registering, and recording bets and wagers upon horse races *against which he could offset* the expenditures for fees and salaries at race tracks." 44 B. T. A. 601. (Emphasis added.)

It is thus apparent that the holding in *Silberman* was consistent with *McKenna* and was in conformity with the

requirements of Section 23(h) of the 1939 Code—that losses from wagering transactions could only be deducted from gains from such transactions.

Since respondents here do "claim that income to be taxed from an illegal business is the net income received therefrom" and did realize gains against which they "*could* offset the expenditures from fees and salaries" (in the words of *Silberman*) by no conceivable construction is *Silberman* any support for petitioner's position that these expenditures *cannot* be offset against such gains.

Silberman, in fact, is clear support for respondents' position that illegal gambling is a business within Section 23(a) and that the wages and rent are ordinary and necessary expenses, deductible from gross income so long as any gross income exists.

In *A. C. Stralla*, 9 T. C. 801 (1947), the operators of an illegal gambling ship claimed as deductions expenditures for fees incurred in defense of criminal actions, for penalties paid the State of California and for lobbying activities and purported "public relations services." All these deductions were disallowed. None of these expenses were clearly "ordinary and necessary" and would not be allowed as deductions in any business, legal or illegal. The Tax Court distinguished these from expenses "made in the actual production of income; deduction of expenses of that character has been allowed." 9 T. C. 801, 802.

Despite the clear distinction drawn in *Stralla* between the two kinds of expenses, it is nonetheless cited by petitioner in support of his general "public policy" argument (Pet. Br. 22). This is a clear demonstration of petitioner's technic of applying a general doctrine without regard to the particulars of the present cases, or to the particulars out of which the doctrine arose.

In *G. A. Comeaux*, 10 T. C. 201 (1948), the Commissioner

again attempted to disallow the ordinary and necessary expenses of an illegal gambling business. The taxpayer operated a "horse-book" establishment in Kansas. For the years 1938 to 1944 the Commissioner denied as deductions sums paid for protection from arrest and prosecution and salaries paid to persons engaged in operating the business, as well as other miscellaneous expenses. It was found by the Tax Court that this enterprise was illegal under the criminal statutes of Kansas. The Tax Court affirmed the Commissioner's disallowance of protection payments, but reversed his disallowance of salary and miscellaneous expenses. In pointing out the distinction, the Tax Court stated, at p. 207:

> "The second issue relates to the deduction of salaries and miscellaneous expenses, the 'legitimate expenses of an illegitimate business.' The amount of such items is not in dispute. These expenses were incurred in earning the income reported by petitioner or attributed to him by respondent. In *Anthony Cornero Stralla*, 9 T. C. 801, at 821, this Court recognized that such expenses are deductible, in contradistinction to those expenses which are not deductible because contrary to public policy. We said: 'The expenditures here in issue were not made in the actual production of the income; deduction of expenses of that character has been allowed.' The income tax law is not a tax on gross income, even if the income be earned in an illegal business. *Commissioner* v. *Heininger*, 320 U. S. 467. The deduction of such expenses depends on the innate character of the item itself. Thus the protection expenses have been disallowed as being contrary to sound public policy or proscribed types of conduct. But items not so to be characterized may be deductible. The distinction may at first seem nebulous, but it is nonetheless real. The items now under discussion are in the latter category and are allowable deductions. The amounts appear in the findings of fact."

The Commissioner did not appeal this decision, but on review of another aspect of the decision raised by the taxpayer's appeal in *Comeaux* v. *Commissioner*, 176 F. 2d 394, 400 (C. A. 10, 1949), the Court said, in passing: "The amounts are not in dispute, and it is agreed that while legitimate expenses incurred in an illegitimate business are deductible, amounts paid for protection are not legitimate business expenses. The Tax Court allowed certain claimed expenses incurred in the operation of the business * * *."

Not only did the Commissioner not appeal in *Comeaux* but he acquiesced in the Tax Court decision in that case as well as in *Stralla*. See 1948—1 Cum. Bull. pp. 1, 3. On page iv of the Internal Revenue Bulletin within which these acquiescences are found appears the following notation:

> "Notice that the Commissioner has acquiesced or non-acquiesced in a decision of the Tax Court relates only to the issue or issues decided adversely to the Government. Decisions so acquiesced in should be relied upon by officers and employees of the Bureau of Internal Revenue *as precedents in the disposition of other cases.*" (Emphasis added.).

The primary significance of *Comeaux* lies not only in the fact that it concerned salary expenses, as do the instant cases, but that the Kansas statute which prompted the Tax Court to find the taxpayer's activities illegal is identical in its operative language with Section 336 of the Illinois Criminal Code, upon which petitioner here relies. Compare Ch. 21-1510, Kan. Gen. Stats., and Ch. 38, Sec. 336, Ill. Rev. Stats. (These statutes are set out in Appendix B to this Brief.)

Subsequent to the acquiescence in *Comeaux*, and until the present cases, the policy of the Internal Revenue Department appears to have been to allow deductions for actual expenses incurred in the production of income from an illegal gambling business. Numerous Tax Court deci-

sions are found in which deductions for rent and salaries in connection with illegal gambling operations have been allowed by the Commissioner without question. See, for example, *S. W. Truman*, P-H T. C. Memo ¶ 49,027 (1949), an Ohio numbers operator allowed deductions for compensation paid to writers and "commission men"; *Mark H. Tinsley*, P-H T. C. Memo ¶ 54,225 (1954), Florida numbers operator allowed deduction for rent; *Marcus H. Hackerman*, P-H T. C. Memo ¶ 54,151 (1954), Tennessee numbers operator allowed deduction for compensation paid writers and pick-up men and wages paid employees; *Jack Lee*, P-H T. C. Memo ¶ 54,203 (1954), Alabama bookmaker allowed salary expense; *Jack Federika*, P-H T. C. Memo ¶ 55,172 (1955), Ohio bookmaker apparently allowed deductions for rent and for salary paid sheetwriters responsible for listing bets; *Louis A. Simon*, P-H T. C. Memo ¶ 55,324 (1955), Wisconsin bookmaker allowed deduction for salary and for bad debt allowance even though debts void and uncollectible by legal action.

Two other Tax Court cases decided after *Comeaux* and before the present cases are also significant, primarily because they are relied on by petitioner in support of his general theory. The first of these is *C. W. Thomas*, 16 T. C. 1417 (1951) (Pet. Br. 22). Thomas operated an illegal game in Florida known as "Bolita" during 1946 and prior years. He was indicted, tried and convicted by Florida authorities early in 1946 for these activities and was sent to the state penitentiary. He sought to deduct from his gross income for the year the attorney fees incurred in defense of the state criminal charges. In denying his contention the Tax Court stated: "The fees were not incurred in the actual production of the income of the illegal business and did not enable him to continue his gambling business," citing *Heininger*, *Stralla* and *Comeaux*. "The petitioner would reduce the cost of unsuccessfully defending

himself against a criminal charge by deducting the expense from his taxable income and thus, in effect, having the Federal Government assist in his defense. The allowance of a deduction would be against public policy. The amount is not an ordinary and necessary expense of any business regularly carried on by the taxpayer," again citing *Stralla* and *Comeaux*. *Ibid.*, 1418.

Here the Tax Court by citing *Stralla* and *Comeaux* recognized that attorney fees paid in the unsuccessful defense of a criminal suit are different from expenses incurred in the production of income, such as rent and wages.

The second decision is *Charles A. Clark*, 19 T. C. 48 (1952), where the deductibility of payments made to a California municipality to allow the taxpayer to engage in an illegal slot machine business was denied. "The payments resemble the 'protection payments' held nondeductible in *G. A. Comeaux*, 10 T. C. 201, aff'd. 176 F. 2d 394", 19 T. C. 48, 52.' The reliance of *Clark* on *Comeaux* which clearly distinguished protection payments from salary payments under a Kansas statute identical to Section 336 of the Illinois Criminal Code hardly establishes *Clark* as authority for the proposition that the rent and salary expenses in the present cases are not deductible. Yet *Clark* is cited by petitioner without drawing the distinction between expenses for protection and expenses for rent and wages (Pet. Br. 23).

The Tax Court's position in *Comeaux* was reaffirmed in its consideration of *Charles V. Doyle*, P-H T. C. Memo ¶ 54,340 (1954). There the identical issues raised in the present cases were considered by the Tax Court. Taxpayer was engaged in the unlawful business of bookmaking in Illinois. The Commissioner sought to disallow his deductions for rent and wages on the very same theory here advanced. The Tax Court held the expenses deductible on the author-

ity of *Stralla* and *Comeaux*. Thus the decision of the Seventh Circuit Court of Appeals in *Commissioner* v. *Doyle*, 231 F. 2d 635 (C. A. 7, 1956); upon which it predicated its decisions in the present cases, affirmed the Tax Court—which may seem somewhat surprising in view of the implication of petitioner's argument that the decisions below are some kind of mutant in the field of tax litigation.

In its decision in *Mesi* the Tax Court simply ignored what had been done in *Doyle* and sought to explain away *Comeaux* as "clearly distinguishable" because "the record in the instant case establishes that the payments in question constituted the illegitimate expenses of an illegitimate business, whereas no such finding of fact was made in *G. A. Comeaux*." (R. 92.) The Tax Court in *Mesi* acknowledged that both cases involved the deductibility of wages paid to employees in an illegal bookmaking establishment (R. 92). The Tax Court in *Comeaux* found the business to be illegal under Kansas Statutes. The relevant Kansas and Illinois statutes are identical. Under these circumstances the "clear" distinction between *Mesi* and *Comeaux* appears to be that in one the deduction was allowed and in the other it was not. The Tax Court in *Mesi* simply accepted petitioner's "public policy" argument without question and disregarded completely and without explanation the language of Section 23(a). It recognized that "the disallowance of the instant expenditure may be almost tantamount to taxing petitioner on his gross rather than his net income." This was apparently all right in the Tax Court's view, because "it is axiomatic that deductions are a matter of legislative grace." (R. 93.) However, the Tax Court gave no clue as to why it thought the legislative grace had not been bestowed by the plain terms of the statute. The reversal of that decision on the authority of the statute by the Court below was manifestly correct.

4. Petitioner's Theory That Deductions Under Section 23(a) Are Dependent Upon State Law Is Refuted by Legislative History, and If Adopted Would Cast Doubt Upon the Constitutionality of the Statute.

Thus up until the Tax Court decisions in the present cases, the Commissioner and Tax Court followed a practice consistent with the ruling in *Comeaux* and the acquiescence in that decision, and applied Section 23(a) exactly as it was written. In the taxation of gambling enterprises, unlawful under state law, the enterprise was treated no differently than a lawful business and ordinary and necessary expenses such as wages, rent and telephone were allowed, and expenses not ordinary or necessary, such as protection payments, bribes, or fees for unsuccessful defense of criminal actions, were not allowed.

The plain language of the statute which appears to draw no distinction between lawful and unlawful business or between lawful and unlawful expenses is clearly supported by legislative history respecting illegal gambling. The issue first arose during consideration of the Revenue Act of 1913. Section II (A) and (G) (b) of that act provided for the deduction of "necessary expenses actually paid in carrying on a business" including a provision for the deduction of "losses actually sustained during the year, incurred in trade." During debate on the section, which was the prototype of Section 23(a), question was raised about illegal or illegitimate trade and an amendment was offered to add the qualifying words "ordinary and legitimate" before the word "trade". The amendment was rejected. 50 Cong. Rec. 3850.

During the course of the debate on this subject, the purpose of the bill was explained by Senator Williams, a member of the Finance Committee and in charge of the income tax provisions of the bill:

"* * * The object of this bill is to tax a man's net in-

come; that is to say, what he has at the end of the year after deducting from his receipts his expenditures or losses. It is not to reform men's moral characters; that is not the object of the bill at all. The tax is not levied for the purpose of restraining people from betting on horse races or upon 'futures', but the tax is framed for the purpose of making a man pay upon his net income, his actual profit during the year. The law does not care where he got it from, so far as the tax is concerned, although the law may very properly care in another way." 50 Cong. Rec. 3849.

Reference has already been made to the development of the section of the Internal Revenue Code providing that "losses from wagering shall be allowed only to the extent of the gains from such transactions." Sec. 23(h), Internal Revenue Code of 1939; Section 23(g), Revenue Act of 1934. As has been shown, the purpose of this section was to place legal and illegal gambling on the same basis (*supra*, pp. 12-13).

This Congressional attitude toward gambling was reaffirmed during consideration of the Revenue Act of 1951. It was in this Act that first appeared the 10% excise tax on gross receipts from wagering, Section 3285, Internal Revenue Code of 1951, and the $50 special occupation tax and registration requirement for all persons engaged in the business of wagering, Sections 3290 and 3291, of Internal Revenue Code of 1951 (Sections 4401-5, 4411-14, Internal Revenue Code of 1954). These measures were adopted in the wake of the activities of the Special Senate Committee to Investigate Organized Crime in Interstate Commerce, and one of the admitted objects of the tax and the registration requirements was to inhibit the business of gambling. See *United States* v. *Kahriger*, 345 U. S. 22, 27, 35 (1953), upholding its constitutionality.

The Senate and House Reports on the 1951 Revenue bill both made it abundantly clear that there was no question

but that illegal gambling was a business subject to the income tax on the same basis as other business. Thus both reports state:

> "Since its inception, the Federal income tax has applied without distinction to income from illegal as well as legal sources, and it has never been generally supposed that such application carried with it any implied authorization to carry on illegal activities. Moreover, in the field of excise taxes the tax on coin-operated gambling devices has been applied without regard to whether or not the operation of a particular machine is in violation of State or local law." House Report No. 586, p. 55; Senate Report No. 781, p. 113, 82d Cong. 1st Sess. (1951).

This was reaffirmation of the statement by the Court of Appeals for the Seventh Circuit when *Heininger* was before it, *Heininger* v. *Commissioner*, 133 F. 2d 567 (C. A. 7, 1943), aff'd. 320 U. S. 467 (1943), that no distinction has been made by Congress or the Bureau of Internal Revenue between income from legal or illegal business. "Both, so far as the statutes and regulations of the Department went, were to be taxed on their net income." This decision was written by Judge Minton, who was a member of the Senate when the Revenue Act of 1939 was adopted. He pointed out that although this lack of distinction between legal and illegal business was well known to Congress, no change had been made in the law. He stated:

> "If this change is to be made and the policy altered, *let Congress do it.* Congress would need only to add the word 'legal' before the word 'trade' in the third line of Section 23 (a)(1).
>
> We are asked, in the guise of construing the words 'ordinary and necessary', to amend the statute. In other words, to engage in a little judicial legislation. We decline the invitation." 133 F. 2d 567, 570. (Emphasis added.)

Congress itself was asked to make this change and it, too, declined the invitation in 1951. The following is found on the final page of the Senate Report No. 781, p. 120, 82 Cong., 1st Sess. (1951):

> "Tax Treatment of Illegal Activities."
>
> "Several amendments have been proposed to the committee which would affect the tax treatment of gamblers and other persons who receive income from illegal sources. In summary, these amendments would—
>
> (a) Disallow as a deduction from gross income any expenses incurred in illegal wagering and any losses resulting from illegal wagering;
>
> * * * * *
>
> Your Committee believes that additional time is necessary for detailed study of these suggestions and therefore believes that action on them should not be taken at this time. The Committee is fully aware of the importance of a strict enforcement of the income tax laws in this area."

Petitioner attempts to minimize the impact of the refusal by Congress to amend Section 23(a) in 1951, because he says this indicates no intention with respect to the deductibility of payments in themselves illegal. This assumes that there is something unique about expenses for rent and wages not shared by other expenses of an unlawful gambling business (see *infra*, pp. 29-36). It also assumes complete ignorance on the part of Congress of the existence of the Tax Court's decision in *Comeaux*, its affirmance by the Court of Appeals, and the acquiescence by the Commissioner in that decision, and his uniform following of that acquiescence up to that time. In view of the preoccupation of Congress with the question of the taxation of gambling enterprises this assumption is wholly unwarranted.

Clearly indicative of the mood of Congress toward the issue are the debates on the proposal to disallow as a deduction from gross income any expenses incurred in illegal wagering. The amendment was offered by Senator Kefauver, who wanted to eliminate the 10% excise tax and the $50 special tax. 97 Cong. Rec. 12230-31.

Each side to the debate charged that the proposal of the other would interject the Internal Revenue Bureau into purely local matters. Senator Kefauver, in attacking the excise and special tax, quoted from an editorial which had appeared in the Washington *Star*. The editorial observed that it had been said that the Bureau had estimated it would need 3,000 additional agents to enforce the excise and special tax. Senator Kefauver said he thought it would require, not 3,000, but 30,000 to 40,000 men. He then quoted:

> "Such a force would be encroaching on a field hitherto reserved for local law enforcement agencies. Its job would be, first, to determine whether a suspected evader of the gambling taxes actually was engaged in gambling and, second, what his income from that source amounted to. Local police undoubtedly would welcome the invasion of Federal agents into this field, for it would tend to relieve police of a responsibility rightfully theirs.
>
> "But the Internal Revenue Bureau never was intended to become a crime suppression agency * * *." 97 Cong. Rec. 12238.

The chief spokesman against Senator Kefauver's proposal was Senator Johnson, a member of the Finance Committee which sponsored the excise and special taxes. In support of the committee bill he said:

> "Just as the proposed tax does not in any way give Federal authorization to illegal gambling, the bill likewise does not in any way contemplate that the Federal Government will take over the enforcement of

> State and local anti-gambling laws. The primary purpose of the committee's amendment is to raise revenue not to encroach in a field which is fundamentally a local responsibility. We are dealing with a tax bill, not with the criminal code." 97 Cong. Rec. 12238.

Senator Johnson then inserted in the Congressional Record a statement relating to Senator Kefauver's proposals. "Under present law," observed Senator Johnson, "wagering expenses are deductible if they are business expenses." 97 Cong. Rec. 12239.

He raised three primary objections to changing this. First, the distinction for tax purposes between income from legal and illegal sources raised by Senator Kefauver's proposal to prohibit the deduction of the expenses of an illegal gambling enterprise raised serious constitutional issues under *United States* v. *Constantine*, 296 U. S. 287 (1935), because the tax appeared to be a penal rather than a revenue measure. Second, the question was raised as to what law would be looked to to determine illegality. Presumably, concluded Senator Johnson, it would be to the law of a state, and where local option existed, to county and municipal ordinances. "It is suggested that the Federal tax laws should not be made dependent upon the laws of such varied, non-federal jurisdictions," he concluded on this point. 97 Cong. Rec. 12240.

Finally, with respect to the interjection of the Federal government into state matters, he stated:

> "Assuming, however, that the laws of other jurisdictions can be made the basis of the application of the Federal tax laws, the question then arises as to whether a conviction for a violation of some anti-gambling statute will be a prerequisite to the disallowance of gambling losses and expenses, or is it intended that the Federal tax authorities are to have the power to make a conclusive and presumptive determination of the legality or illegality of any par-

> ticular transaction without regard to any judicial determination? If the latter is intended to be the case, it is suggested that this is a wider and more arbitrary authority than has ever been granted in the field of tax collection. On the other hand, if a conviction of a violation of State or local law is intended to be required, then it is suggested either that the proposed amendment will be administratively impractical, or that the Bureau of Internal Revenue will have to associate itself in the enforcement of State and local laws." 97 Cong. Rec. 12240.

Senator Kefauver's proposal was thereupon defeated. 97 Cong. Rec. 12244.

If this was the attitude of the Senate toward making Federal taxation dependent on state law and on associating the Internal Revenue Bureau with local criminal law enforcement, then how much more contrary to this view is the theory advanced by petitioner that taxability should not depend on the legality of the business (as Senator Kefauver proposed), but on the legality of each item of expense? How much more arbitrary for the Tax Court to attempt to decide whether rent or wages, or countless other items of expense, are illegal under Illinois law, while expenses for paper and pencils are not (Pet. Br. 27). Thus even assuming that petitioner's theory of "independently illegal" expenses (Pet. Br. 26), can withstand close scrutiny (see *infra*, pp. 29-36) nonetheless it is clear that such a theory of taxation is at violent odds with what Congress believes to be the proper constitutional basis for a revenue statute. If the Senate could not accept Senator Kefauver's proposal, which at least would have required only one determination of state law (the illegality of the business), it certainly must be concluded that Section 23(a) does not countenance petitioner's theory, even assuming the theory makes any sense at all.

By asking that Section 23(a) be construed so as to allow or disallow deductions based on their legality or illegality under state law, petitioner is asking this Court to place an unconstitutional construction upon an otherwise valid statute. In *United States* v. *Kahriger*, 345 U. S. 22 (1953), the constitutionality of the special occupational tax on those engaged in gambling was upheld, and the tax was distinguished from the tax held invalid in *United States* v. *Constantine*, 296 U. S. 287 (1935), because:

> "The tax in the *Constantine* case was a special additional excise tax of $1,000.00 placed only on persons who carried on a liquor business in violation of state law. The wagering tax with which we are here concerned applies to all persons engaged in the business of receiving wagers, regardless of whether such activity violates state law." 345 U. S. 22, 26.

The Court's reluctance to place a construction upon a statute which would raise serious constitutional doubts is pointed up by *United States* v. *Calamaro*, 354 U. S. 351 (1957). There an effort was made to apply the special occupational tax to a so-called "pick-up" man in a "numbers game" operating illegally in Pennsylvania. (Cf. the opinion in the Court of Appeals, 236 F. 2d 182 (C. A. 3, 1956) for a discussion of the illegal nature of the activities of the "pick-up" man.)

In commenting on the government's argument that the "pick-up" man was a person "engaged in receiving wagers for or on behalf of any person" within the meaning of the statute, the Court stated:

> "The fact remains, however, that Congress did not choose to subject all employees of gambling enterprises to the tax and reporting requirements, but was content to impose them on persons actually 'engaged in receiving wagers.' *Neither we nor the Commissioner are authorized to rewrite the statute simply because*

we may feel that the scheme it creates could be improved upon.

"We can give no weight to the Government's suggestion that holding the pick-up man to be not subject to this tax will defeat the policy of the statute because its enactment was 'in part motivated by a congressional desire to suppress wagering.' The statute was passed, and its constitutionality was upheld, as a revenue measure, *United States* v. *Kahriger*, 345 U. S. 22, and, apart from all else, in construing it *we would not be justified in resorting to collateral motives or effects which, standing apart from the federal taxing power, might place the constitutionality of the statute in doubt.*" 354 U. S. 351, 357-58. (Emphasis added.)

5. Petitioner's Theory of "Independently Illegal" Expenses Is Not Supported by State Law.

Petitioner seeks to avoid the impact of prior Congressional and judicial teaching that the Internal Revenue statutes draw no distinction between income from legal and illegal sources, and that, in Senator Johnson's words, "wagering expenses are deductible if they are business expenses." Petitioner argues that he is not here concerned with the fact that respondents were engaged in an illegal business but that the expenses of wages and rent were themselves made to induce other illegal acts. These other illegal acts were that a landlord leased to respondents space within which to conduct their illegal business and that employees recorded wagers in the course of their employment in respondents' business. The expenditures are "independently illegal" and petitioner seeks to deny them for that reason, "not because the taxpayers are engaged in illegal activities" (Pet. Br. 26, 27).

As respondents have pointed out above, even assuming these expenses were "independently illegal," petitioner must first show a statutory ambiguity permitting the ap-

plication of a policy denying the deduction of expenses otherwise clearly ordinary and necessary. Respondents have also shown that the reasons for the rejection by Congress of a proposal to deny the deduction of all expenses incurred in illegal gambling apply with even greater force to petitioner's theory of "independently illegal" expenses.

However, the fact is that the theory is really a variant of and is dependent upon the "illegal business" theory expressly rejected by Congress.

In a passage which clearly reveals the fallacies in petitioner's "public policy" and "independently illegal" expense arguments, he states:

> "We emphasize at the outset that this case does not involve a type of expenditure which would be any more deductible if it were made by a taxpayer engaged in a lawful rather than an unlawful business. Nor are we contending that Congress intended to tax the gross income of one business and the net income of another. Rather, the expenditures here—being illegal in themselves and, in fact, payments for the commission of crimes—would not be deductible by a taxpayer engaged in a legitimate business" (Pet. Br. 13).

This passage makes sense only if one completely ignores the fact that the expenditures about which petitioner is writing are for wages and rent. It is utterly impossible to conceive of this argument being made in connection with a lawful business. If these expenses are illegal it is *because* of the business, not despite it. Respondents could hardly be charged by petitioner with inducing their landlord to lease premises to them for an unlawful purpose if the business were not unlawful. Nor could they be charged with aiding and abetting their employees to record wagers in violation of the Illinois statutes if respondents' business were not in violation of the Illinois statutes. The argument may seem superficially plausible because respondents

were in fact engaged in an unlawful business, but here the circle has come full, for petitioner premises his argument on the fact that no distinction is made by him because respondents were engaged in an illegal business.

If these expenses of wages and rent should not be allowed as deductions because respondents aided and abetted the landlord or employees in committing a crime, then why should respondents be allowed a deduction for expenses incurred for inducing others to become aiders and abettors in their crime of carrying on illegal gambling? If respondents aided and abetted their employees and landlord, did not they likewise aid and abet the furnishers of their wire service, who themselves aided and abetted respondents? The furnishers of this service "which gives information over a loud speaker such as the time when the race commenced, the progress of the race until it ended, the result, and then the odds payable at the track to the winners" (R. 8) were certainly aiders and abettors in respondents' operations? The printer and supplier of safety tickets (R. 8) or 20-line sheets (R. 83-4) or hard cards (R. 8, 83), used in the illegal business, aided and abetted respondents, and respondents in turn must have aided and abetted them. But respondents were principals in all their expenditures, not merely aiders and abettors in some. It is not apparent on what theory petitioner would treat respondents more favorably when they are principals than when they are only aiders and abettors.

There is certainly no consistency in petitioner's regard for Illinois "public policy" when he recognizes as ordinary and necessary expenses the federal excise tax on wagers and the special occupation tax on persons engaged in gambling. It is of course conceivable that persons pay the $50 special tax without intending to then proceed to engage in an unlawful business, but the excise tax can only have been generated out of illegal activities.

Respondents do not contend that any crime under Illinois law is committed by the federal government in collecting either the excise tax or special tax, but Illinois "public policy" does not seem to be any less frustrated by allowing taxpayers engaged in unlawful businesses to deduct these expenses but not allowing them to deduct rent and wage expenses.

It is the height of sophistry to permit a deduction of rent by a bookmaker if he conceals from his landlord the unlawful use of the premises but to deny the deduction if the landlord was advised of the purpose, and then to allow a deduction for excise taxes paid on gross receipts from the unlawful busines where the recipient knows how the gross receipts were produced. The inevitable logic of petitioner's position is to impose a gross income tax on persons engaged in illegal gambling activities. But this result has been expressly rejected by Congress. Petitioner's position is no less contrary to the Congressional purpose because he travels only part way toward the goal to which his logic leads.

If petitioner is correct, then the Commissioner, and presumably the Tax Court, and successive reviewing courts, would have to determine whether those dealing with a taxpayer in an illegal business were, themselves thereby engaging in illegal activities. If only the taxpayers were illegally involved, then presumably the expenditure would be within Section 23(a). If the recipient of the expenditure were also involved in taxpayer's illegalities, then presumably, under petitioner's theory, the expenditure would not be allowed. Since the Commissioner and Tax Court would by hypothesis be applying local law, then local decisions interpreting the statutes and relationships would be relevant. Thus, it might be necessary to determine if the landlord in the Ross-Sullivan enterprise in-

sisted that the tenants carry on their illegal business, and not merely tolerated it.

In *McKeown Bros. Co. v. Ogden Kennel Club*, 269 Ill. App. 622 (1933), it was contended that lien claimants should be denied relief because their claim arose out of the construction of a dog track, including structures for pari-mutuel betting. Since gambling on dog racing is contrary to Illinois law, and since the claimants knew the purpose for which they were erecting the structures, it was contended the liens were invalid as contrary to Illinois "public policy." In denying this argument and holding the liens valid, the Illinois court relied on an earlier Illinois Supreme Court case, *Hoefeld v. Ozello*, 290 Ill. 147 (1919).

The issue in the *Hoefeld* case was the legality of a lease which permitted the lessee to terminate in the event the State Sunday-closing law was generally enforced. The argument was made that the landlord had knowledge that the lessee intended an unlawful use of the premises. In denying this claim, the Illinois Supreme Court cited the following with approval:

> "Although the lessor may have had knowledge that the premises would be used for an immoral purpose, unless, coupled with that knowledge, there was an intention on his part when he executed the lease that the premises should be used for such immoral purpose, the lease contract would not be void. * * * The lessor is not the keeper of the conscience of the lessee and has no police control over him in such matters, and mere knowledge on the lessor's part that the lessee is going to use the premises for an unlawful purpose does not make the lessor a participant in that purpose, for mere knowledge that the lessee may or will use the premises for an unlawful purpose is not, of itself, sufficient to show that the lessor intended that they must or shall be so used." 290 Ill. 147, 150.

Whether this decision would have any effect upon a criminal prosecution against a landlord under Section 336 of the Illinois Criminal Code does not seem to have been argued in the Illinois courts. But it could well be urged that Section 336 must be interpreted in light of that decision, and that the mere finding that the landlord "knowingly permitted these rooms to be used for the purposes of bookmaking" (R. 11) is not a crime under Section 336.

This argument is valid not only because of the implication of the *Hoefeld* decision but because of *People* v. *Viskniskki*, 155 Ill. App. 292 (1910), a criminal action against a landlord for knowingly renting premises to be used for a gaming house. The Court, in finding one of the instructions erroneous, stated that it was not an offense for the landlord to suffer or permit occupancy to continue for the balance of the lease term when he first had knowledge of its unlawful use after the term commenced. Section 336 does not speak in terms of "knowingly rent" but rather "knowingly permitting," but the result would appear to be the same.

In this connection it should be noted that the Tax Court in its decision in *Ross-Sullivan*, stated that it was clear that the lessor was "fully aware that an illegal bookmaking enterprise was being carried on upon the premises" (Pet. Br. 15), and not that lessor knew at the time of leasing that such enterprise would be carried on.

The problem inherent in petitioner's efforts to determine questions of Illinois criminal law through the expedient of Tax Court findings is further illuminated by a passing footnote reference he makes to the Illinois Conspiracy statutes. "Moreover, in making the payments of rent and wages and thus inducing the payees to violate Section 336 of the Criminal Code of Illinois, the taxpayers also

appear to have been conspirators within the meaning of Sections 139 and 140 of the Illinois Revised Statutes (1945), c. 38 (Criminal Code)." (Pet. Br. p. 29, fn. 14.) In *People* v. *Dorman*, 415 Ill. 385 (1953) it was held that an indictment under Section 139 charging a conspiracy to violate Section 336 did not lie, the Court stating:

> "We hold that the legislature did not intend the conspiracy statute to include bookmaking. Neither does there appear to be any authority to support a finding that conspiracy to keep a book was an indictable offense at common law. In *People* v. *Monroe*, 349 Ill. 270, it is stated that 'betting on horses is not *malum in se* but it is only *malum prohibitum*.'" 415 Ill. 385, 389.

These considerations of Illinois law may appear somewhat esoteric in determining the impact of a federal taxing statute. But if the petitioner is going to make the federal law dependent upon state criminal law, taxpayers ought to be able to raise whatever arguments they might raise in a state criminal proceeding. It is rather apparent that it was precisely this kind of situation that Senator Johnson correctly anticipated might arise if federal revenue laws were related to the legality or illegality of transactions under state or municipal laws. The assumption of power by the Tax Court to make these kinds of determinations of state criminal law is clearly inconsistent with the refusal by Congress to grant the power requested for the Treasury Department by Senator Kefauver in 1951.

That petitioner is really interested in striking down respondents' expenditures because of the illegal nature of the business, rather than because of any inherent characteristic of the expense involved, is made clear by his treatment of the taxpayer in *Tank Truck Rentals, Inc.* v. *Commissioner*, 243 F. 2d 14 (C. A. 3, 1957), pending on writ of certiorari No. 109. The issue in that case is the deductibility by taxpayer of fines imposed on its drivers

by Pennsylvania and other states for driving overloaded trucks. Here there would be no need to speculate on whether wages paid by taxpayers to these drivers induced the commission of an illegal act, since the fines against the drivers clearly attest to that fact. Nor would there be any need to speculate on whether taxpayer was an aider—or—abettor within the meaning of the Pennsylvania statute that "every person who shall counsel, aid or abet the commission of any misdemeanor punishable under any act of Assembly for whom no punishment is provided, shall be liable to be proceeded against and punished as the principal offender." Purdon Pa. Stats., Title 18, Sec. 5105. For taxpayer in *Tank Truck* admits the trucks were intentionally overloaded, and in fact argues that they had to be for the business to operate profitably. Yet despite these factors the strong public policy which overwhelms petitioner in the instant cases never seems to have occurred to him in *Tank Trunk Rentals*, for wages there paid to individual drivers to violate the state laws are unquestioned. (Cf. Brief for Tank Truck Rentals, in No. 109, p. 40.)

The distinction between the two situations is only that here taxpayers have been engaged in illegal gambling, not that there is anything unique about their rent and salary expenses.

6. Petitioner Has Attempted to Usurp the Legislative Function, and Hence Has Acted Beyond the Scope of His Authority.

The effort of the petitioner to accomplish by administrative practice what Congress has refused to do by statutory amendment is an effort to usurp the legislative function. Attempts in the past by the Commissioner and other administrative officials to act in derogation of the statutes

they administer have been uniformly rebuffed. The supremacy of the Congressional power in this area was recognized in *Marquette Cement Mfg. Co.* v. *Federal Trade Commission*, 147 F. 2d 589, 592-93 (C. A. 7, 1945): "Congress is the creator of all inferior federal courts, as well as administrative agencies. The jurisdiction and authority of each is confined solely to that which Congress bestows. There are no limitations upon this congressional power other than the Constitution."

In *Federal Communications Commission* v. *American Broadcasting Co.*, 347 U. S. 284 (1954), the efforts of the F. C. C. to extend its own powers to accomplish an end which it considered socially desirable were reviewed by this Court. There the F. C. C. adopted regulations providing for the denial of licenses to radio and television stations broadcasting "give-away" programs. In affirming the judgment of the district court in restraining the enforcement of these regulations, the Court succinctly summarized the issue:

> "It is apparent that these so-called 'give-away' programs have long been a matter of concern to the Federal Communications Commission; that it believes these programs to be the old lottery evil under a new guise, and that they should be struck down as illegal devices appealing to cupidity and the gambling spirit. It unsuccessfully sought to have the Department of Justice take criminal action against them. Likewise, without success, it urged Congress to amend the law to specifically prohibit them. The Commission now seeks to accomplish the same result through agency regulations. In doing so, the Commission has overstepped the boundaries of interpretation and hence has exceeded its rule-making power. Regardless of the doubts held by the Commission and others as to the social value of the programs here under consideration, such administrative expansion of § 1304 does not provide the remedy." 347 U. S. 284, 296-97.

In *Western Union* v. *Lenroot*, 323 U. S. 490, 508-9 (1945), the Court stated: "To translate this Act by a process of interpretation into an equivalent of the bills Congress rejected is, we think, beyond the fair range of interpretation. Declining that, we cannot sustain the Government's bill of complaint."

See also *United States* v. *Halseth*, 342 U. S. 277, 281 (1952).

The administrators of the tax statutes occupy no higher position with respect to Congress than do other administrators.

Thus in *Manhattan General Equipment Co.* v. *Commissioner*, 297 U. S. 129, 134 (1936), it was said concerning the administration of the tax laws:

> "The power of an administrative officer or board to administer a federal statute and to prescribe rules and regulations to that end is not the power to make law—for no such power can be delegated by Congress—but the power to adopt regulations to carry into effect the will of Congress as expressed by statute. A regulation which does not do this, but operates to create a rule out of harmony with the statute, is a mere nullity."

See also *Koshland* v. *Helvering*, 298 U. S. 441, 446-47 (1936); *Helvering* v. *Powers*, 293 U. S. 214, 224 (1934); *United States* v. *200 Barrels of Whiskey*, 95 U. S. 571, 576 (1877).

Petitioner's motivation in deviating from the *Comeaux* doctrine, impliedly approved by Congress when it refused to adopt Senator Kefauver's suggestions in 1951, appears to have been the urging of the Attorney General who announced in a speech that he was promised the co-operation of the Treasury Department in a program to disallow all deductions for expenses incurred in illegal gambling operations as not being "ordinary and necessary." Vol. 78,

Reports of the American Bar Assn., (1953), p. 338. (See Paul, The Use of Public Policy by the Commissioner in Disallowing Deductions, U. of So. Cal. School of Law Tax Institute (1954), p. 715, for a criticism of this speech and the "public policy" doctrine.) Petitioner is obviously aware of the difficulties of an approach as unsubtle as that suggested by the Attorney General in the light of the clear statutory statement and announced Congressional intent, so he has evolved the theory of "independently illegal" expenses, no less objectionable than the Attorney General's theory of "illegal business."

It is apparent that petitioner is using the position of authority entrusted to him to impose his notions of morality and social justice upon respondents through arbitrary use of the taxing power. Such a use of power was commented upon by Justice Jackson in his concurring opinion in the decision upholding the constitutionality of the 1954 wagering tax. He considered that legislation to be a plan to tax out of existence the professional gambler, and stated:

> "It will be a sad day for the revenues if the good will of the people toward their tax system is frittered away in efforts to accomplish by taxation moral reforms that cannot be accomplished by direct legislation. But the evil that can come from this statute will probably soon make itself manifest to Congress. The evil of a judicial decision impairing the legitimate taxing power by extreme constitutional interpretations might not be transient." (*United States* v. *Kahriger*, 345 U. S. 22, 36 (1953).)

Much greater by far is the evil implicit in the arbitrary action of the petitioner here in flouting the express mandate of Congress to accomplish what he thinks are desirable moral reforms. The Attorney General does not display a keen awareness of the significance of constitutional processes when he requests that the federal revenue system be administered in this manner.

"Statutes should be construed, as far as possible, so that those subject to their control may, by reference to their terms, ascertain the measure of their duty and obligation, rather than that such measure should be dependent upon the discretion of executive officers, to the end that ours may continue to be a Government of written laws rather than one of official grace." *United States* v. *Northern Pacific Ry. Co.*, 242 U. S. 190, 195 (1916).

CONCLUSION.

For the foregoing reasons, the judgments of the Court below should be affirmed.

Respectfully submitted,

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APPENDIX A.

Revenue Ruling 54-219, Internal Revenue Cumulative Bulletin 1954-1, page 51.

"Regulations 118, Section 39.23(a)-1: Rev. Rul. 54-219 Business Expenses.

"The Federal excise tax on wagers under section 3285(d) of the Internal Revenue Code and the special tax under section 3290 of the Code paid by persons engaged in receiving wagers are deductible, for Federal income tax purposes, as ordinary and necessary business expenses under section 23(a) of the Internal Revenue Code, provided the taxpayer is engaged in the business of accepting wagers or conducting wagering pools or lotteries, or is engaged in receiving wagers for or on behalf of any person liable for the tax under sections 3285(d) of the Code."

APPENDIX B.

Illinois' Revised Statutes.

Chapter 38, Criminal Code of State of Illinois:

"336. Book-making and pool-selling unlawful.

§ 1. *Be it enacted by the People of the State of Illinois, represented in the General Assembly:* That any person who keeps any room, shed, tenement, tent, booth, or building, or any part thereof, or who occupies any place upon any public or private grounds within this state, with any book, instrument or device for the purpose of recording or registering bets or wagers, or of selling pools, or any person who records or registers bets or wagers, or sells pools upon the result of any trial or contest of skill, speed or power of endurance of man or beast, or upon the result of any political nomination, appointment or election, or being the owner, lessee or occupant of any room, shed, tenement, tent, booth, or building, or part thereof, knowingly permits the same to be used or occupied for any of these purposes, or therein keeps, exhibits or employs any device or apparatus for the purpose of recording or registering such bets or wagers, or selling of such pools, or becomes the custodian or depository for hire or privilege, of any money, property, or thing of value staked, wagered or pledged upon any such result, shall be punishable by imprisonment in the county jail for a period not longer than one year, or by fine not exceeding $2,000 or both. Provided, however, that the provisions of this act shall not apply to the actual enclosure of fair or race track associations that are incorporated under the laws of this state, during the actual time of the meetings of said associations, or within twenty-four hours before any such meetings."

Kansas General Statutes:

"Ch. 21, Par. 21-1510.

"*Bookmaking or selling pools, or permitting on premises; penalty.* That any person who keeps any room, shed, tenement, booth or building, or any part thereof, or who occupies any place upon any public or private grounds within this state with any book, instrument or device for the purpose of recording or registering bets or wagers or selling pools, upon the result of any trial or contest of skill, speed or power of endurance of man or beast which is to be made to take place within or beyond the limits of this state, except within the inclosure of a race track and upon races or trials of speed being conducted within said inclosure (provided that the exception herein shall not apply to any race track or inclosure for more than two weeks in any one year), or any person who records or registers bets or wagers, or sells pools upon the result of any trial or contest of skill, speed or power of endurance of man or beast, which is to be made or take place within or beyond this state, or upon the results of any political nomination, appointment or election which is to be made or held either within or beyond the limits of this state, or being the owner, lessee or occupant of any room, shed, tenement, booth or building, or part thereof, knowingly permits the same to be used or occupied for any of the purposes hereinbefore prohibited, or therein keeps, exhibits or employs any device or apparatus for the purpose of registering such bets or wagers, or selling pools, as are hereinbefore prohibited, or becomes the custodian or depositary for hire or privilege of any money, property or thing of value which is staked, wagered or pledged contrary to the provisions of this act, shall be guilty of a misdemeanor, and on conviction shall be punished by imprisonment in the county jail for a period of one year and by a fine of one thousand dollars."